(20)

Office - Supreme Court, U. S.

OCT 9 1942

CHARLES ELMORE CROPLEY
CLERK

IN THE

Supreme Court of the United States

OCTOBER TERM, 1942—NOS. 354 AND 355.

IN THE MATTER
of
THE AKRON, CANTON & YOUNGSTOWN RAILWAY COMPANY,
Debtor,

THE AKRON, CANTON & YOUNGSTOWN RAILWAY COMPANY, Debtor,
Petitioner,
vs.
GEORGE E. HAGENBUCH and H. B. STEWART, Jr., Trustees etc., *et al.*,
Respondents.

M. H. CHAMBERLAIN, holder of record of all of the common stock of The Akron, Canton & Youngstown Railway Company, Debtor, as Successor Trustee, and THE OHIO NATIONAL BANK OF COLUMBUS, OHIO, THE CHASE NATIONAL BANK OF THE CITY OF NEW YORK, CHEMICAL BANK & TRUST COMPANY OF NEW YORK, and UNION PROPERTIES, INC., as beneficial owners of common stock of said The Akron, Canton & Youngstown Railway Company, Debtor,
Petitioners,
vs.
GEORGE E. HAGENBUCH and H. B. STEWART, Jr., Trustees etc., *et al.*,
Respondents.

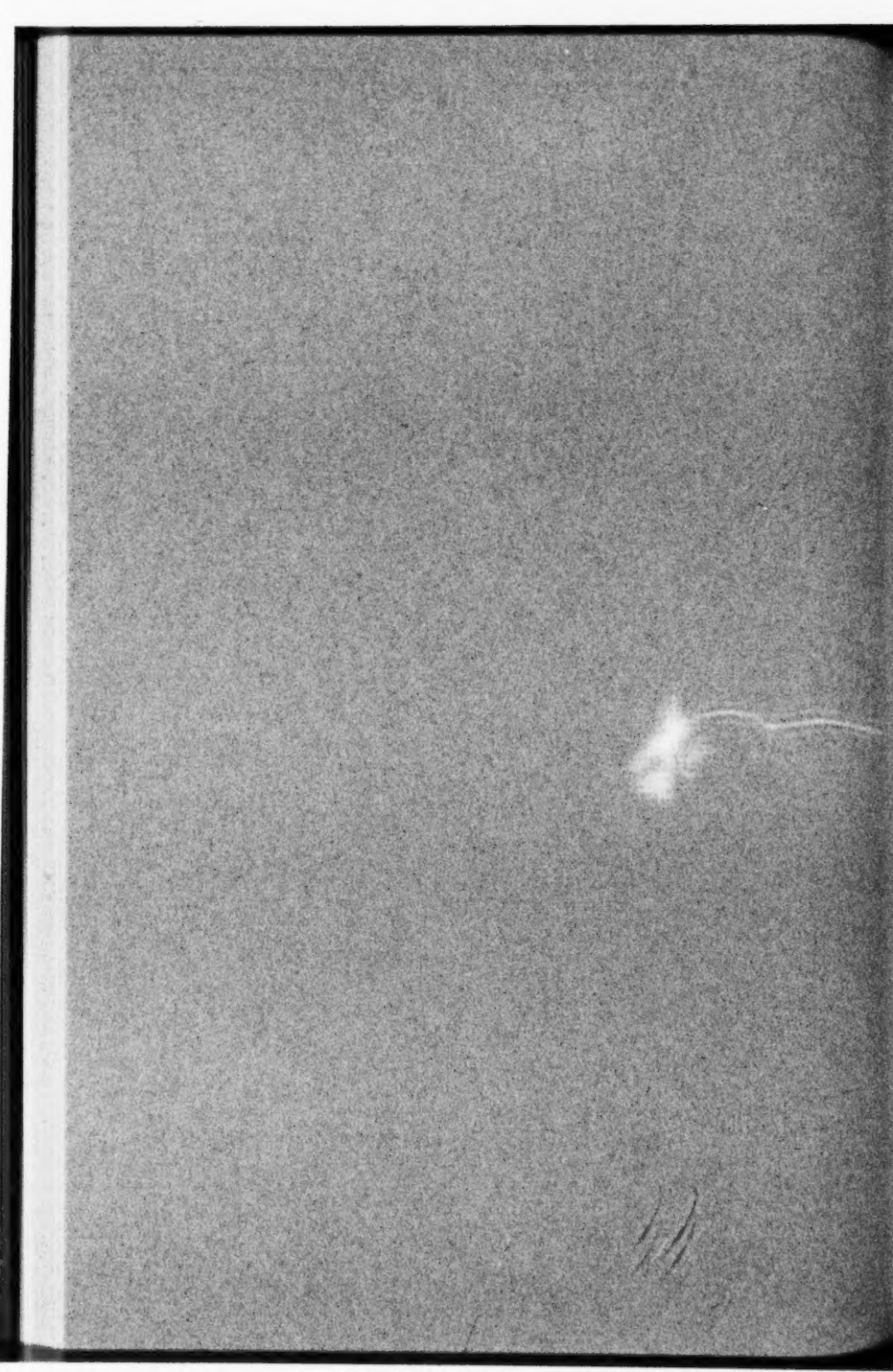
REPLY BRIEF FOR PETITIONERS.

PAUL D. MILLER,
JOHN WALLS,
Attorneys for Petitioners.

JUDGE, STERN, WILLIAMS & TUCKER,
20 Pine Street,
New York, New York;

JONES, DAY, COCKLEY & REAVIS,
1759 Union Commerce Building,
Cleveland, Ohio,
Of Counsel.

October 8, 1942.



INDEX.

	PAGE
The Elimination of the Stockholders under the Plan	2
The Stockholders' Right to Challenge the Fairness of the Plan in this Court	4
The Lack of Adequate Findings	6
The Conclusiveness of the Findings of the Commission as to Value	7
The Applicability of the Doctrine of the *Atchison* Case	10
The Fairness of the Plan as to the Stockholders	11
Conclusion	15

IN THE

Supreme Court of the United States

OCTOBER TERM, 1942—NOS. 354 AND 355.

IN THE MATTER

of

THE AKRON, CANTON & YOUNGSTOWN RAILWAY COMPANY,
Debtor,

THE AKRON, CANTON & YOUNGSTOWN RAILWAY COMPANY, Debtor,
Petitioner,

vs.

GEORGE E. HAGENBUCH and H. B. STEWART, Jr., Trustees etc., *et al.*,
Respondents.

WM. H. CHAMBERLAIN, holder of record of all of the common stock of The Akron, Canton & Youngstown Railway Company, Debtor, as Successor Trustee, and THE OHIO NATIONAL BANK OF COLUMBUS, OHIO, THE CHASE NATIONAL BANK OF THE CITY OF NEW YORK, CHEMICAL BANK & TRUST COMPANY OF NEW YORK, and UNION PROPERTIES, INC., as beneficial owners of common stock of said The Akron, Canton & Youngstown Railway Company, Debtor,

Petitioners,

vs.

GEORGE E. HAGENBUCH and H. B. STEWART, Jr., Trustees etc., *et al.*,
Respondents.

REPLY BRIEF FOR PETITIONERS.

Separate briefs in opposition have been filed by the Debtors' Trustees, the Committee for the Akron Bonds, and the Committee for the Northern Bonds, said briefs being referred to, respectively, as the Trustees' brief, the Akron brief, and the Northern brief.

The brief of the Northern bondholders states (Northern brief, p. 22):

> "We shall not and do not need to argue the petitioners' 'Reasons for Granting the Writ'. Such force as those reasons might have, *if the case and the 'Questions Presented' were as stated by the petitioners,* is, we submit, wholly missing in fact because of the true case presented."[1]

This extraordinary challenge to the basic accuracy of the petition, together with inaccurate and misleading statements in the several briefs in opposition, warrants a brief reply.

All three briefs deal largely with arguments on the merits. While many of such arguments are ill-founded, this reply is confined to these assertions in the briefs in opposition which bear directly upon petitioners' right to the writs sought and which challenge the accuracy with which petitioners have presented their case.

The Elimination of the Stockholders under the Plan.

All three respondents challenge the assumption, underlying the petition, that for all practical purposes, the Akron stockholders are excluded from participation in the reorganization. They assert, or at least seek to give the impression, that the stockholders are not "wiped out" but, on the contrary, will probably receive up to $190,142 or $211,867 of new common stock (Northern brief, p. 17; Akron brief, p. 5; Trustees' brief, pp. 3-4). Although this fact, if true, would scarcely affect petitioners' right to certiorari (since they contend that the stockholders' equity is worth far more than $190,142 or $211,867), the statements in respondents' briefs are highly misleading.

---

[1] All italics in quotations are supplied.

After pointing out that the plan nominally allocates Class B conditional warrants to the stockholders, entitling them, subject to the prior contingent claim of the Nickel Plate Railroad, to a maximum of $190,142[2] par value of new common stock, the petition states (p. 5):

> "Although the precise amount of the Nickel Plate claim is not yet fixed, the Debtors' Trustees have estimated that the amount thereof will be such that only $6,542 of such common stock, representing *65 out of a total of 22,987 shares* (less than ⅓ of 1%), will go to the stockholders."

This statement was predicated upon exhibits introduced at the hearing before the District Court on the confirmation of the plan *by the Debtors' Trustees, not by petitioners,* which indicated that the Nickel Plate claim would approximate $183,600 (R. 981, 983, 971-972), thus leaving only $6,542 of new stock for the present stockholders. The accuracy of this estimate was not questioned by any party at the time; *and no facts are stated in the briefs in opposition which indicate that such estimate was then or is now inaccurate.* On the basis of said exhibits, which represent the only evidence before the courts below as to the probable amount of the Nickel Plate claim, this case was argued before both the District Court (see R. 1064) and the Circuit Court of Appeals (see R. 1137-1138) on the theory that, *for all practical purposes,* the plan eliminates the stockholders. Thus, the court below stated (R. 1137-1138):

> "In its report, the Commission fixed the value of the debtors' properties for capitalization at $8,500,000. When this value was distributed among the debtors, creditors and stockholders, * * * *only $6,542 par value of the securities of the reorganized*

[2] Some of the respondents compute this figure as $211,867.21 (Akron brief, p. 5; Trustees' brief, pp. 3-4).

corporation as provided under the plan was available for the debtors' stockholders."

While it is thus *theoretically* possible, as pointed out in the petition, for the stockholders to receive under the plan a maximum of $190,142 (or $211,867) of new common stock, there is not the slightest probability that this will actually happen; and there is nothing in the record, nor any *facts* stated in the briefs in opposition, which warrant this case being treated other than one in which the stockholders take substantially nothing under the plan.

The Stockholders' Right to Challenge the Fairness of the Plan in this Court.

Although respondents do not specifically assert that petitioners have no standing here to contend that the Debtors' properties have a value greatly in excess of $8,500,000, throughout their briefs appear statements designed to suggest that the petition should be denied because "petitioners did not object to the $8,500,000 *capitalization*" at the original hearing before the Special Master (Akron brief, pp. 6, 15; Northern brief, pp. 4-5, 10-11, 12-13, 21-23). Although the point would not seem presently important, since concededly it was raised before the District Court upon the confirmation of the Plan (see R. 1063) and before the Circuit Court of Appeals, we desire to point out the misleading character of these suggestions.

At the hearing before the Special Master, the petitioners (in an obvious effort to indicate to the Court the possibility of according substantial recognition to the stockholders not only within the general structure of the Commission's plan but even within the limits of the approved total capitalization) suggested that the rights of the stockholders

could be recognized, if the plan were remanded to the Commission, by amending the plan so as to (a) substitute income debentures for the proposed preferred stock, (b) substitute preferred stock for the proposed common stock, and (c) accord to the Akron stockholders 24,300 shares of new common stock of no par value, or of the par value of $1 a share (R. 713-714). Since it was suggested that this separate stock be taken into the capital structure at a nominal value, the resulting *nominal* total capitalization was less than $8,500,000 (R. 714); but under said proposal *the present stockholders would have received all the new common stock!*

While it is thus literally true that, before the Special Master, the petitioners did not in terms object to the $8,500,000 *capitalization* as such (since they considered that under their proposal the stockholders could be accorded *all* the common stock of the new company within the limits of such capitalization), the important thing is that at that time (see R. 712), as at every other stage of these proceedings, *the stockholders made clear their contention that the value of the Debtors' properties was such as to warrant very substantial recognition to them.*

In view of this fact, which respondents do not deny, the suggestion that the petition should be denied because the stockholders did not in express terms argue for a higher *capitalization* at the original hearing before the Special Master rests upon the sheerest kind of technicality.[3]

---

[3] Attention is called to the statement, in italics, in the Akron brief (p. 6) that "The petitioners did not object to the Special Master's report." What purpose this statement serves, save to mislead, is not apparent. The petitioners had filed objections to the Plan (R. 709-724), which were heard and passed upon by the Master (R. 739-861). Thereafter, a hearing was had upon briefs and oral argument before the District Court, in which the petitioners contended that the equity of the stockholders possessed a

The Lack of Adequate Findings.

The petition asserts (p. 12), as one reason for granting the writs, that in holding that the Commission made adequate findings as to the value of the Debtors' properties, as a basis for eliminating the stockholders, the decision of the court below is directly in conflict with that of the Ninth Circuit in the *Western Pacific* case. In support of this claim the petition sets forth (pp. 13-14), in parallel columns, the findings of the Commission as to the value of the debtor's properties in the *Western Pacific* case and the corresponding findings in the case at bar.

The Akron bondholders challenge this comparison by suggesting, if not indeed stating, that the language quoted by petitioners from the Commission's findings in the *Western Pacific* case was taken from an early report which had been superseded by a later report and therefore was not before the Ninth Circuit Court of Appeals. Thus, it is stated that in the report which was *"before the Ninth Circuit there is no language at all comparable to that quoted by petitioners"* (Akron brief, p. 21). This statement is inaccurate and seriously misleading.

The Commission's findings in the *Western Pacific* case are reflected in not one, but three, reports, namely, its initial report and order (230 I. C. C. 61; see p. 194 *et seq.* of the Record in No. 7, Present Term); its report and order on further consideration (233 I. C. C. 409; see p. 300 *et seq.*, Record No. 7, Present Term); and its order denying the

---

substantial value, as is made clear in the court's opinion (R. 868-869). Since it was perfectly clear at this hearing that the stockholders were claiming that they were entitled to substantial recognition, as respondents do not deny, the fact that the petitioners did not file formal objections to the Special Master's report is wholly irrelevant.

further petition of the debtor for modification of the plan (236 I. C. C.; see p. 884 *et seq.*, Record No. 7, Present Term). All these reports were, of course, before the Ninth Circuit. The great bulk of the Commission's findings in the *Western Pacific* case appears in its said initial report. While the report on further consideration modifies the initial report by making certain changes in the amounts of securities to be issued and otherwise, said report on further consideration does not in any sense supersede or replace the initial report except as to the modifications specifically provided for. *And there is nothing whatever in the Commission's report on further consideration which supplants or supersedes the basic findings in its initial report, dealing with the value of the stockholders' equity, which is quoted in the petition.*

The Conclusiveness of the Findings of the Commission as to Value.

The petitioners assert (p. 18), as one reason for granting the writs, that in holding that the Commission had exclusive jurisdiction to determine the value of the Debtors' properties the decision of the court below is in conflict with the *Western Pacific* and other cases.

Challenging this claim, the Northern bondholders state (Northern brief, p. 19) that in the case at bar "Neither the District Court nor the Circuit Court of Appeals held the Commission's findings to be 'conclusive'." As to this, it is necessary only to point out that the court below specifically held (R. 1151) that "The determination of the value of the properties * * * are legislative functions affecting the public interest *and are exclusively within the province of the Commission under the Act.*"

The Akron bondholders admit (brief, pp. 21-22) the conflict claimed but say that it is immaterial because here the District Court did make a truly independent determination as to the value of the Debtors' properties. Whether this is so or not depends upon a study of the opinions of the Special Master and the District Judge which lack of space here precludes. Suffice it to say that petitioners' exposition of this point completely convinced the court below which made no attempt to sustain the order appealed from on the ground that the District Judge had independently arrived at the same conclusion as the Commission respecting the value of the Debtors' properties.[4]

Petitioners further assert (Pet., p. 18), as a reason for granting the writ, that in holding that the Commission had exclusive jurisdiction to determine the value of the Debtors' properties, the decision of the court below is clearly wrong; and they point out that since the purpose of the valuation here in question was to determine whether the stockholders

---

[4] A good idea of the approach made to this problem in the District Court may be obtained from the following statement by the Special Master at the outset of the hearing on objections to the plan (R. 743, 856):

> "I think there isn't any question about the matter of valuation. *That is solely for the Interstate Commerce Commission, not for the Court, and on this record we certainly are bound by the finding of the Commission,* presumably upon satisfactory evidence, that the values of the system and of the component parts thereof are as set forth in the report.
>
> "* * * The determination of value by the Commission *is final and binding upon the Court.* * * * the finding of the Commission in this regard must be accepted by this Court, unless it clearly appears from the record that *the Commission failed to give due consideration to the various factors involved.* * * *."

A mere glance at the brief opinions of the District Court (R. 868-869, 1062-1065) suffices to show that the judge surveyed the Commission's report only to the extent of ascertaining whether there was any evidence to support its conclusions.

are to be deprived of their property, "due process" requires that the valuation be made judicially.

Apparently for the purpose of showing that petitioners have no status to raise this point, the Northern bondholders state (Northern brief, p. 18):

> "At no time before the I. C. C., the District Court, or the Circuit Court of Appeals, have the petitioners raised any question under the Fifth Amendment (or any other constitutional question). We say this without fear of contradiction notwithstanding the passing comment in Judge Hamilton's opinion below."

Petitioners can offer no explanation for this surprising declaration, since the fact is that numerous references to constitutional issues appear in petitioners' briefs in the court below. For example, at page 13 of petitioners' main brief, under a sub-heading entitled—

> *"The principal contentions to which we shall address ourselves in this brief* * * * ",

appeared the following:

> "The District Court, misconceiving its function and erroneously believing itself bound by the Commission's conclusions as to the lack of any equity for the stockholders, did not itself review those conclusions or consider the fairness of the Plan to the stockholders, thereby depriving the stockholders of the judicial review of the Commission's findings required by Section 77(e) and by the Federal Constitution."

Again, at page 21 of said brief:

> "The stockholders' equity in the Debtors' assets is clearly a property interest, protected by the Fifth Amendment to the Federal Constitution, * * *".

And again, at page 62:

> "Where, as here, the question is one of confiscation of property, 'due process' requires that the valuation be made *judicially.*"

Other like references could be given.

The Applicability of the Doctrine of the *Atchison* Case.

Petitioners assert (Pet., p. 24), as one reason for granting the writs, that in refusing to remand the plan to the Commission for reconsideration thereof in light of radically changed economic conditions and greatly increased earnings, the decision of the court below is in conflict with *Atchison, etc., Ry. Co.* v. *United States,* 284 U. S. 248 (1932).

Respondents challenge the applicability of the doctrine of the *Atchison* case largely because, they assert, the Debtors' high earnings of 1940 and 1941 are wholly abnormal as indicated by the fact that their earnings have progressively declined since September, 1941 (Akron brief, p. 13; Northern brief, p. 19; Trustees' brief, pp. 3, 17-18, 24). Thus, the Akron bondholders assert that while operating revenues increased $139,642 during the eight months ended August 31, 1942, as compared with corresponding period of 1941, net income declined $154,195; that while operating revenues in the month of August, 1942, were in excess of those of a year ago, net income was $30,743 less than a year ago (Akron brief, p. 13). Respondents seek to give the impression that the decreased net earnings, in spite of substantial increases in operating revenues, are due to increased costs and taxes. They fail to point out, however, the greatly increased, and wholly abnormal, maintenance expenses. The fact is that during said eight months' period maintenance expenses were $188,725.80 in excess of those for the corresponding period in 1941; and

in the month of August, 1942, such expenses were $36,527.86 in excess of those for August, 1941.[5]

What has happened in this respect is that the Trustees, in the latter half of 1941, embarked upon an extensive improvement program which involved, in addition to capital expenditures, heavy expenses incidental thereto but chargeable, under railroad accounting practice, as operating expenses. While the program is undoubtedly of merit, from the viewpoint of increasing future earning power, it has compressed into a comparatively few months of 1941 and 1942 heavy expenditures for permanent improvements. Disregarding these temporary and wholly abnormal maintenance expenses for the purpose of testing real earning power, and giving effect to increased wages and taxes, the Debtors' earnings for 1942 *have not only been maintained at a very high level but are much better than for corresponding months of 1940 and not greatly less than for the corresponding months of 1941.* This result has been achieved notwithstanding the almost complete curtailment, pending completion in 1943 of great synthetic rubber plants, of the tire and other rubber manufacturing operations which the Akron bondholders assert account for a great proportion of the Debtors' traffic (Akron brief, p. 12). It is reasonable to assume that the present high level of earnings will be substantially expanded when synthetic rubber becomes available to make up the cumulative deficiencies in the nation's stock of rubber goods.

The Fairness of the Plan as to the Stockholders.

Without attempting to reply to the many ill-founded arguments on this issue in the several briefs in opposition,

[5] These figures are obtained from the monthly reports filed by the Trustees with the District Court (see Petition, p. 26, footnote 6).

we wish to refer to two contentions advanced by the respondents.

Respondents' use of "adjusted earnings" figures: Respondents seek to discredit the Debtors' high earnings, both past and present, as indicated in the petition (see pp. 3, 25, 33), by suggesting that the Debtors' earnings as "adjusted" were much lower than their *actual* earnings as stated pursuant to the Commission's classifications of accounts. Thus, referring to the fact that the Debtors' average "reported" earnings for the 11-year period 1926-1936 were $551,088 per year, the Akron bondholders assert that the Debtors' earnings for this period "adjusted to eliminate uncollectible items, to correct improper accounting, to give effect to certain taxes, etc." averaged only $347,536; and they state that such "adjusted earnings" are "the only ones having any value as a basis for estimating earning power" (Akron brief, pp. 9-10). These statements are seriously misleading.

In the first place, figures in the petition for earnings of the Debtors exclude all "uncollectible items."

In the second place, the "adjusted earnings" figures for 1926-1936 referred to by the respondents do not represent "adjustments" *made by the Commission,* as respondents infer, but "adjustments" made by Mr. Wilkerson, an employee of the Trustees (R. 601, 663).

In the third place, said "adjustments" were not made by Mr. Wilkerson for the purpose of eliminating "uncollectible items" or correcting "improper accounting", as the respondents assert (Akron brief, pp. 9-10),[6] but for the purpose (R. 601) of *deducting* from the Debtors' *actual*

[6] "Adjustments" of such character, which are reflected in the earnings figures used in the petition and the propriety of which petitioners readily endorse, would reduce said figure of $551,088 to $508,585 (R. 663), but not to the figure of $347,536.

earnings for the years 1926-1936 "taxes, unusual expenses and so forth" encountered or anticipated *in the years subsequent thereto;* and this was done without any effort to *add* anything to actual earnings for 1926-1936 to reflect additional earnings from increased traffic, increased rates, more effective operating technique, and improved facilities! In other words, said adjustments represented a purely hypothetical study *whereby new taxes, increased costs, etc., encountered or anticipated in 1937, when the study was made, were applied retroactively to earnings of prior years!* In theory such a study, if accurately done, might have some bearing upon estimated future earning power, provided all *favorable* factors, encountered or anticipated in 1937, were likewise applied retroactively. Mr. Wilkerson's study reflected only the retroactive application of the *unfavorable* factors; and this was done on a basis which even Mr. Wilkerson did not approve.

Although the Commission copied Mr. Wilkerson's so-called "adjusted earnings" figures in its Report (R. 663), it made no comment whatever thereon, and there is no indication whatever that it gave any weight thereto. The author of the figures himself, while recognizing the value of *actual* earnings in estimating earning power (R. 602), stated that he did not consider the "adjustments" which he had made "of any great value", and that he did "not attach a great deal of importance to a study of this kind" (R. 602); and he indicated the peculiar worthlessness of these particular "adjustments" by pointing out (R. 601) that from actual earnings he had deducted taxes, unusual expenses, and so forth *"a great many of which did not apply to our company"!*

Comparisons with other reorganizations: The petitioners assert (Pet., p. 30), as one reason for granting the writs, that the plan is unfair to the stockholders, that it

is irreconcilable with all other plans approved by the Commission in Section 77 proceedings, and that the stockholders were reasonably justified in rejecting it. In support of this contention the petition (pp. 31-37) presents comparisons showing that on the basis of both past earnings and prospective earnings the stockholders in the case at bar have been dealt with by the Commission much more harshly than the stockholders in any other reorganization.

Respondents challenge (Akron brief, footnote, p. 16) said comparisons because, they assert, "No such comparisons can have any value without a knowledge of all the facts of such other cases * * *". Although this contention, in so far as it relates to the comparableness of the figures, is answered in the petition (p. 32), its implication that the fairness of the plan as to petitioners may not be determined with reference to the treatment accorded to creditors and stockholders in other railroad reorganizations under Section 77 is not well founded. A railroad reorganization is not a concept peculiar to the case at bar. On the contrary, this reorganization is merely one of many, as to which there has evolved a well developed art of reorganization. The challenged comparisons in the petition relate solely to a fundamental principle of this art, *i. e.*, the capitalization of earning power. Such comparisons are entirely feasible because the earnings compared were all determined under the uniform system of accounts established by the Commission for all steam railroads. And if, as shown in the petition, the capitalizations approved in all other plans of reorganization have, in effect, capitalized average prospective earnings at 3.37% and average past earnings at 3.34% while the plan here in question capitalizes prospective earnings and average past earnings *at ratios some 50% higher,* it is submitted that the stockholders were abundantly "justified in rejecting" the plan.

Conclusion.

Nothing is set forth in the briefs in opposition which successfully negatives any of the grounds upon which the writs prayed for are sought. The petition should be granted.

Respectfully submitted,

PAUL D. MILLER,
JOHN WALLIS,
Attorneys for Petitioners.

MUDGE, STERN, WILLIAMS & TUCKER,
20 Pine Street,
New York, New York;

JONES, DAY, COCKLEY & REAVIS,
1759 Union Commerce Building,
Cleveland, Ohio,
Of Counsel.

October 8, 1942.